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LEGAL UPDATE

January 19, 2010

To: Superintendents/Presidents, Member Community College Districts

From: Loren Soukup, Schools Legal Counsel *LS*

Subject: Determination of Independent Contractor Status
Memo No. 04-2010(CC)

In August 2009, the United States Government Accountability Office issued a report titled "Employee Misclassification: Improved Coordination, Outreach, and Targeting Could Better Ensure Detection and Prevention." The Report calls for increased focus on the misclassification of employees as independent contractors and enforcement by the Department of Labor's Wage and Hour Division during its targeted investigations.¹ The Department of Labor (DOL) has announced that beginning in 2010 it will be focusing on its investigations and enforcement practices by increasing its wage and hour investigators by more than one third and imposing severe penalties upon employers that violate federal labor standards.² The Internal Revenue Services (IRS) has also announced that it will be implementing the "Employment Tax National Research Project" (Project) to study changes in business practices concerning employment tax issues. As part of the Project, the IRS will be auditing approximately 6,000 companies over the next three years to determine compliance with employment tax areas.³ These new aggressive enforcement positions provide a reminder that community college districts must be knowledgeable about what services may be obtained from a person on an independent contractor basis.

The consequences of such decisions are important for such issues as: social security; STRS and PERS retirement contributions; state and federal income tax withholdings; employment derivative issues (e.g., workers' compensation or unemployment insurance); and job rights (e.g., tenure, holiday pay, sick leave, or wages).

¹ <http://www.gao.gov/new.items/d09717.pdf>

² <http://www.dol.gov/opa/media/press/whd/whd20091452.htm>

³ <http://www.irs.gov/businesses/small/article/0,,id=215350,00.html>

By way of example, a community college district might hire a consultant as an independent contractor instead of as an employee and find out later that the law considers the person to be a classified employee. Mischaracterizing the consultant as an independent contractor may have short-term advantages such as lower costs and greater flexibility on retaining and terminating the person. The long term costs of mischaracterizing the consultant can be enormous: IRS penalties, back taxes, retroactive wages, and permanent status.

To aid community college districts in analyzing this issue we have enclosed a copy of the IRS Considerations and 20 Factors used to determine whether an employee is an independent contractor. The memorandum offers a summary of the most important topics to consider in determining whether an individual is an independent contractor. We strongly recommend that the IRS checklist be reviewed and used by your district in making decisions before retaining “consultants” or “independent contractors.”

Please contact any of our attorneys if you have questions regarding this issue.

EMPLOYEE OR INDEPENDENT CONTRACTOR?

In recent years, the Internal Revenue Service (IRS) has sought out and imposed severe penalties on companies that treat employees as independent contractors, and which fail to withhold taxes. To avoid the paperwork burden and expense of payroll taxes, some employers inappropriately designate workers "independent contractors." If the IRS determines that the worker is actually an "employee," the person responsible for the collection and payment of withholding taxes may be held personally liable for an amount equal to the taxes that should have been withheld.

The IRS considers 20 factors in determining a worker's status. Meeting just one of the conditions may qualify the worker as an employee. If a company is unable to determine the appropriate designation from the IRS guidelines, the IRS will help. Simply file a Form SS-8 and the IRS will respond with a determination. A summary of the IRS position and the 20 factors are provided below:

IRS Considerations and the 20 Factors

An **employer** must generally withhold income taxes; withhold and pay social security and Medicare taxes; and pay unemployment taxes on wages paid to an employee. An employer does not generally have to withhold or pay any taxes on payments to **independent contractors**.

To help determine whether an individual is an employee under the common-law rules, the IRS has identified 20 factors that are used as guidelines to determine whether sufficient control is present to establish an employer-employee relationship.

These factors should be considered guidelines. Not every factor is applicable in every situation, and the degree of importance of each factor varies depending on the type of work and individual circumstances. However, all relevant factors are considered in making a determination, and no one factor is decisive. It does not matter that a written agreement may take a position with regard to any factors or state that certain factors do not apply if the facts indicate otherwise.

The 20 factors indicating whether an individual is an employee or an independent contractor are:

- 1. Instructions.** An employee must comply with instructions about when, where, and how to work. Even if no instructions are given, the control factor is present if the employer has the right to control how the work results are achieved.
- 2. Training.** An employee may be trained to perform services in a particular manner. Independent contractors ordinarily use their own methods and receive no training from the purchasers of their services.
- 3. Integration.** An employee's services are usually integrated into the business operations because the services are important to the success or continuation of the business. This shows that the employee is subject to direction and control.
- 4. Services rendered personally.** An employee renders services personally. This shows that the employer is interested in the methods as well as the results.
- 5. Hiring assistants.** An employee works for an employer who hires, supervises, and pays workers. An independent contractor can hire, supervise, and pay assistants under a contract that requires him or her to provide materials and labor and to be responsible only for the result.
- 6. Continuing relationship.** An employee generally has a continuing relationship with an employer. A continuing relationship may exist even if work is performed at recurring although irregular intervals.
- 7. Set hours of work.** An employee usually has set hours of work established by an employer. An independent contractor generally can set his or her own work hours.

8. Full-time required. An employee may be required to work or be available full-time. This indicates control by the employer. An independent contractor can work when and for whom he or she chooses.

9. Work done on premises. An employee usually works on the premises of an employer, or works on a route or at a location designated by an employer.

10. Order or sequence set. An employee may be required to perform services in the order or sequence set by an employer. This shows that the employee is subject to direction and control.

11. Reports. An employee may be required to submit reports to an employer. This shows that the employer maintains a degree of control.

12. Payments. An employee is generally paid by the hour, week, or month. An independent contractor is usually paid by the job or on straight commission.

13. Expenses. An employee's business and travel expenses are generally paid by an employer. This shows that the employee is subject to regulation and control.

14. Tools and materials. An employee is normally furnished significant tools, materials, and other equipment by an employer.

15. Investment. An independent contractor has a significant investment in the facilities he or she uses in performing services for someone else.

16. Profit or loss. An independent contractor can make a profit or suffer a loss.

17. Works for more than one person or firm. An independent contractor is generally free to provide his or her services to two or more unrelated persons or firms at the same time.

18. Offers services to general public. An independent contractor makes his or her services available to the general public.

19. Right to fire. An employee can be fired by an employer. An independent contractor cannot be fired so long as he or she produces a result that meets the specifications of the contract.

20. Right to quit. An employee can quit his or her job at any time without incurring liability. An independent contractor usually agrees to complete a specific job and is responsible for its satisfactory completion, or is legally obligated to make good for failure to complete it.